IN THE
Supreme Court of the United States
OCTOBER TERM, 1975

No. 75-1556

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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Petitioner, the Public Service Commission of the State of New York (New York), respectfully prays that a writ of certiorari be issued to review the opinion and judgment of the United States Court of Appeals for the District of Columbia Circuit entered in this case on January 27, 1976.

OPINIONS BELOW

The opinion of the Court of Appeals of the District of Columbia Circuit of January 27, 1976 from which review is sought has not yet been reported. It is set

out as Appendix A to the Petition for a Writ of Certiorari to review the same opinion of the Court of Appeals being simultaneously filed in *Associated Gas Distributors* v. *Federal Power Commission*. The orders of the Federal Power Commission of April 16, 1973 and June 21, 1973, in *Mobil Oil Corporation, et al.* which are in issue in this proceeding are reported at 49 F.P.C. 1009 (1973) and 49 F.P.C. 1411 (1973) respectively. The Commission's orders in *Continental Oil Company, et al.* of April 27, 1973 and June 1, 1973 are not reported. All of these Commission orders are set out as Appendix B to the Associated Gas Distributors (AGD) petition.

JURISDICTION

The opinion and judgment of the Court below was entered on January 27, 1976. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

QUESTION PRESENTED

Whether the Federal Power Commission properly authorized producers of natural gas to charge the higher new gas rate for flowing gas sales when their initial sales contracts expired and they entered into replacement contracts, in the absence of any showing in the rate increase proceedings that any of the increased revenues would be devoted to additional gas search efforts for the interstate market, on the basis of a policy statement in a rule making proceeding which also provided no factual predicate for the Commission's action.

STATUTORY PROVISIONS INVOLVED

The relevant portions of the Natural Gas Act 15 U.S.C. § 717 *et seq.*, are set out as Appendix C to the Appendix to the AGD Petition for Certiorari.

STATEMENT OF THE CASE

This case involves consolidated actions to review orders of the Federal Power Commission in two proceedings which had the effect of authorizing a number of producers to charge the area new gas rate for sales of flowing gas from the Texas Gulf Coast and Other Southwest production areas solely because their initial contracts had expired and the producers had entered into new contracts with the pipelines calling for similar service at a higher rate. The first of these two sets of proceedings, *Mobil Oil Corporation (Operator)*, Docket Nos. CI73-450 and CI73-451, 49 F.P.C. 1009, 1411 (1973), involves an abandonment of a sale by Mobil to Shell Oil Company for resale to Texas Eastern Transmission Corporation at the old gas rate for the Texas Gulf Coast Area, and simultaneous authorization of a "new" sale of the same gas by Mobil to Texas Eastern at the new gas rate for the area. The Public Service Commission of the State of New York (New York) did not participate in this proceeding at the Commission level. AGD's petition for review of the Commission's action therein was consolidated by the Court of Appeals for argument and decision with review actions brought by AGD and New York from the orders of the Commission of April 27, 1973 and June 1, 1973 in *Continental Oil Company, et al.*, FPC Gas Rate Schedule No. 3, *et al.*, which approved rate increases filed by Continental, Phillips Petroleum Company and Getty Oil Company which, on the basis of replacement contracts, permitted them to charge the area new gas rate for sales of flowing gas which had previously been limited to the applicable area old gas rates.

The Public Service Commission of the State of New York is a regulatory body established under the laws of the State of New York having jurisdiction *inter alia* over the operations of distributors of natural gas at

retail in the state. Almost all of the gas sold in the state is acquired by those distributors from interstate pipelines subject to the jurisdiction of the Federal Power Commission (Commission), who in turn secure most of their gas directly or indirectly from independent producers pursuant to sales regulated by the Commission. Consequently, New York, in order to protect the interests of gas consumers in its state, has for a number of years found it necessary to participate actively in Commission proceedings involving both the pipelines serving the state and looking towards the fixing of just and reasonable area or national rates for producer sales to the pipelines.

A. The Administrative Background

Since the initiation of group rate making in the *Permian Basin Area Rate Proceeding*, 34 F.P.C. 159 (1965), affirmed *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), the Commission has consistently fixed two sets of just and reasonable rate ceilings, one for flowing gas and another higher level for new gas. The flowing gas rate was and is established essentially to reflect the average historical costs of existing production, but the new gas rates have been fixed on a current cost basis intended to encourage an enhanced gas search effort by the producers. As the Commission found in its *Permian* opinion, 34 F.P.C. at 186, "the two-price system . . . provides a price for the future related to current and future costs and payable only to producers who discover gas-well gas and dedicate their discoveries to the interstate market" while "avoiding windfalls to those producers who acquired and sold gas under lower cost conditions." See also *Permian, supra*, 390 U.S. at 798.

The dividing line between new and old gas was normally fixed in the area proceedings at some date around the commencement of the proceeding, and, as a matter of convenience, *Permian* and the subsequent area rate

proceedings applied these dates to individual sales on the basis of whether or not the sales contract had been made before or after the date chosen. See 34 F.P.C. at 189. The Commission recognized in its original *Permian* opinion, however, that overly rigid adherence to contract date vintaging could be detrimental to the public interest. Accordingly it instituted therein (34 F.P.C. at 1068-1072) a separate proceeding leading to Opinion No. 567, *Hugoton-Anadarko Area Rate Proceeding (Committed Acreage)*, 42 F.P.C. 727 (1962), in which it specified that all gas produced from deeper drilling in previously committed acreage would secure the new gas price, regardless of the date of the underlying contracts governing such sales.

This concept was further expanded in 1972 when the Commission in establishing its *Optional Procedure for Certificating New Producer Sales of Natural Gas*, 48 F.P.C. 218 (1972), *affirmed* in major part in *Moss* v. *FPC*, 502 F.2d 461 (D.C. Cir., 1974) and as to the remainder by this Court in *FPC* v. *Moss*, Case No. 74-883, decided March 3, 1976, made its procedure for seeking rates in excess of the established ceilings for new sales of gas applicable to all *wells* drilled after April 6, 1972, regardless of whether the acreage was already dedicated to interstate commerce. In taking this action to "encourage full development of such acreage", the Commission stated its belief that its policy of distinguishing between new and old gas on the basis of contract date "had failed to achieve full development of dedicated acreage" (48 F.P.C. at 227). But it also emphasized that the optional procedure was "directed at supplies of gas not available to the interstate market prior to April 6, 1972. The rulemaking does not authorize rate increases for gas already flowing in interstate commerce through wells drilled prior to April 6, 1972 . . . [thus] consumers will not pay higher rates except for new supplies and then only to the extent that the contracting parties establish

on record that the price to be paid is required by the public interest" (48 F.P.C. at 220).

While the Commission continued to maintain the distinction between old and new gas, it recognized that situations would exist where increases in flowing gas rates could make additional gas available to the interstate market. Procedures for seeking such increases had been written into all of the area rate orders. See *Permian Basin Area Rate Cases, supra*, 390 U.S. at 770, 771. And upon proper showings the Commission has in fact granted substantial relief to producers. See, *e.g. Shell Oil Company*, 49 F.P.C. 108 (1973); *George Mitchell and Associates*, 49 F.P.C. 424 (1973). Moreover, on November 8, 1972 the Commission moved to institutionalize this procedure by the issuance in Docket No. R-458 of a proposed policy statement, subsequently finalized on April 23, 1973, to encourage producers to seek rate increases in excess of area flowing gas rates where reduced well pressure, need for reconditioning of wells, deeper drilling or other circumstances made additional production of existing wells uneconomic at existing flowing gas ceilings.[1] In short, as of the time of the initiation of the present proceeding, Commission procedures already existed whereby producers with flowing gas could secure higher rates, before or after the expiration of the initial sales contract, if and to the extent that they could show a need therefor to maintain or increase production. Such procedures were supported by New York and other consumer representatives, as proper exercises of the Commission's authority to "employ price functionally in order to achieve relevant regulatory purposes." (*Permian Basin Area Rate Cases, supra*, 390 U.S. at 797.)

[1] *Policy With Respect to Sales Where Reduced Pressure, Need For Reconditioning, Deeper Drilling or Other Factors Make Further Production Uneconomical at Existing Prices*, 49 F.P.C. 992 (1973), codified as 18 C.F.R. § 2.76.

On December 12, 1972, however, the Commission suddenly took a different tack. In Opinion 639, the Commission rejected a proposed higher new gas rate for the Appalachian Basin production area (supported by New York) in favor of individual producer utilization of the newly adopted "optional procedure" (See *supra*, p. 5), again stressing that this procedure would permit higher prices for new gas sales where they were instituted without increasing the rates for flowing gas. *Area Rates for the Appalachian and Illinois Basin Areas*, 48 F.P.C. 1299, 1307. However, by way of dictum the Commission stated that in view of its objections to "vintaging by contract date" it considered "vintaging to be an anachronism which we should now work to eliminate" (48 F.P.C. at 1309). Accordingly it indicated that it would henceforth adopt a literal interpretation of its various area rate orders under which sales of flowing gas would be eligible for the higher new gas rates where intial sales contracts had expired and the parties entered into new sales contracts.

The lawfulness *vel non* of this statement of policy was subsequently affirmed in *Shell Oil Company* v. *F.P.C.*, 491 F.2d 82 (5th Cir., 1974), as a permissible exercise of Commission discretion to interpret its own orders. However, the Court recognized the potential validity of the claims by New York and others that the gas supply objectives underlying the Commission's policy might be impaired rather than aided by the Commission's new policy, and made clear that its action was not to be taken as a blanket approval of all future actions by the Commission to eliminate vintaging; "in each future rate order the Commission must continue to produce substantial evidence to support each essential element of the proposed rate structure" (491 F.2d at 89-90).

B. The Instant Proceedings

On December 21, 1972, nine days after the issuance of Opinion 639, Mobil filed an application to abandon service it had been making pursuant to an expired contract with Shell Oil Company and to sell the gas to Texas Eastern Transmission Corporation at the established new gas price for the Texas Gulf Coast production area. Since the gas in question had been resold by Shell to Texas Eastern at the old gas price for the area, the effect of the series of transactions was to increase the price of the gas of Texas Eastern. Mobil supported its applications solely by reference to Opinion 639; the new contract it entered into with Texas Eastern did not commit Mobil to expend any of the additional revenues it would receive on new or expanded gas exploration, development or production efforts for Texas Eastern and nothing in the record before the Commission indicates that such expenditures would in fact be made. The applications were protested by AGD because of this deficiency. But the Commission by order of April 16, 1973, 49 F.P.C. 1009, summarily rejected the protest and approved the applications on grounds they were consistent with the policy it had enunciated in Opinion 639. AGD's petition for rehearing was similarly rejected out of hand. 49 F.P.C. 1411 (1973).

On March 20, 1973, the Commission gave notice of three rate increases filed by Continental Oil Company, Phillips Petroleum Company and Getty Oil Company, seeking in purported compliance with the Opinion 639 policy statement to secure the relevant area new gas rates for sales of flowing gas upon the expiration of the initial sales contracts and the entering into of new contracts at the higher new gas rate between the producer and the pipeline which had receiving service. Again there was no attempt by the producers to show that they had contracted to devote any of the increased revenues

in additional gas search efforts or contemplated doing so. However, despite protests by New York and AGD the Commission by order of April 27, 1973, accepted the rate increase filings and permitted them to go into effect without suspension solely on grounds that they were consistent with the Opinion 639 policy statement. Both New York and AGD filed petitions for rehearing. New York's petition for rehearing was summarily rejected by order of June 1, 1973. AGD's petition for rehearing was ignored by the Commission, but pursuant to Section 1.34 of its Rules of Practice and Procedure, 18 C.F.R. 1.34, was deemed to be denied by passage of time.

In the court below AGD's petition for review of the Commission's *Mobil* order (Case No. 73-1794) was consolidated for oral argument and decision with the petitions brought by AGD (Case No. 73-1793) and New York (Case No. 73-1647) from the orders in the Continental, Phillips and Getty proceeding. On January 27, 1976 the Court, with Judge Robinson dissenting, affirmed the Commission. See AGD Petition, Appendix A. The Court majority believed that the Commission could adopt a "literal" interpretation of its contract date distinction between old and new gas in its various area rate orders to achieve the gradual elimination of the two price system it had established in these orders, in view of the findings in Opinion 639 as to existing gas supply shortage, increased costs of finding and producing gas, and the alleged decline in production efforts under the existing rate structure.

Judge Robinson in his dissent pointed out that the adequacy of Commission's existing area rates (which have since been superseded by nationwide rates for new gas, including new wells on previously dedicated acreage, 17-34 cents per Mcf higher than when Opinion 639 was issued), was not involved in these proceedings.

The question instead was whether there was any basis for assuming that permitting producers to receive the higher new gas rate for low cost flowing gas whenever they entered into replacement contracts would be likely to result in substantial additional gas for the interstate market. As Judge Robinson pointed out that there were no Commission findings in either Opinion 639 or the orders approving the rate increases on this question. Nor was there any factual predicate in either the rule making proceeding leading to Opinion 639 or the individual rate increase cases from which it could logically be concluded that the producers would devote any significant percentage of the increased revenues they would secure for their flowing gas sales to additional efforts on behalf of the interstate gas consumers asked to pay the bill. In these circumstances he concluded that a departure from the two-price system approved by this Court in the *Permian Basin Area Rate Cases*, 390 U.S. 747, 798 because it "will both provide a useful incentive to exploration and prevent excessive producer profits", to give the producers the new gas price for their oldest and lowest cost gas would not provide gas consumers with the "effective bond of protection from excessive rates and charges" which this Court in *Atlantic Refining Company* v. *Public Service Commission*, 360 U.S. 378, 388 (1959) found was a basic requirement of the Natural Gas Act.

REASONS FOR GRANTING THE WRIT

1. The issue in this case is whether the Federal Power Commission could properly interpret its outstanding area rate orders as authorizing producers to automatically secure the new gas price for their oldest vintages of flowing gas when the initial sales contract expired and the producer and pipeline entered into a new contract for the same service but at a higher rate.

The result of the Commission's action is similar to that subsequently incorporated into its nationwide producer rate order in Opinion No. 699-H in Docket No. R-389-B, which is the subject of pending petitions for certiorari filed by New York and AGD in case Nos. 75-1304 and 75-1305.[2] The present proceeding, however, is not subsumed by the Commission's subsequent action in the nationwide rate case. The Commission's nationwide rate order, though applicable to all "replacement contracts" entered into after January 1, 1973 (and those signed previous to that date with respect to initial sales contracts expiring on or after January 1, 1973) is effective only as of June 21, 1974. The present case will control the large number of increased rate filings and millions of dollars in rate increases which, like the specific filings involved in this case, were filed in the two year period between the Commission's enunciation of its policy in Opinion No. 639 and its opinions in Docket No. R-389-B.[3]

2. The orders under review do not purport to rest on any factual base other than that the producers entered into new sales contracts with the purchasing pipelines after the expiration of the initial sales contract and as such meet the requirements of the Commission's statement of policy enunciated in Opinion 639, *Area Rates for the Appalachian and Illinois Basin Areas*, 48 F.P.C. 1299, 1309-10 (1972), for qualifying for

[2] *Just And Reasonable National Rates For Sales Of Natural Gas From Wells Commenced On Or After January 1, 1973, And New Dedications of Natural Gas To Interstate Commerce On Or After January 1, 1973*. A similar issue is raised *inter alia* in the petition filing by the American Public Gas Association in case No. 75-1304.

[3] AGD and/or New York have intervened in protest to over 200 separate rate increase filings before the Commission involving replacement contracts, and review proceedings of all Commission orders permitting such increases on the basis of the Opinion 639 policy statement are pending in the Court of Appeals for the District of Columbia Circuit.

the area new gas rates. Specifically, there is no suggestion that any of the producers committed themselves to any new efforts to develop or produce additional gas for the interstate market as consideration for the higher rates afforded them by the new contracts.[4] Nor were there any Commission findings in Opinion 639 that a "literal" interpretation of previous area rate orders, in direct opposition to their stated intent,[5] to permit producers to secure the higher new gas rate for a sale of flowing gas whenever they enter into replacement contracts, would be likely to result in any substantial increase in the gas supplies made available to the interstate market, to say nothing of increased supplies commensurate with the increased costs to consumers. Moreover the contentions by New York and AGD that the Commission's policy would be counter-productive unless the producers were required to demonstrate their willingness to expend some or all of the increased revenues on additional efforts on behalf of the interstate market were ignored by the Commission.

The majority of the court below, while recognizing the speculative nature of the Commission's action, thought the factual predicate necessary to support the Commission's orders could be found in its findings in Opinion 639 that there was a substantial shortfall of natural gas supplies for the interstate market, which the existing area rates had been unable to cure, plus certain indications that exclusive reliance upon vintaging by contract date would impair new drilling on committed acreage. Assuming the existence of a factual

[4] The expiration of the initial sales contract would not authorize the producer to cease service to the pipeline in accordance with its outstanding certificate. See *Sun Oil Company* v. *FPC*, 364 U.S. 170 (1960).

[5] See *Permian Basin Area Rate Cases*, 390 U.S. 747, 795-798 (1968).

predicate in the record of the rule making proceeding which led to Opinion 639 (which was not directed to the question of the rate treatment of gas sold under replacement contracts), these findings merely establish the existence of a problem and do not in any way support the validity of the particular Commission solution thereof. See *FPC* v. *Texaco, Inc.*, 417 U.S. 380, 396-399 (1974). As Judge Robinson's dissenting opinion below makes clear, considerably more is required by way of findings based on record data as to the likelihood that the increased rates for flowing gas will lead to new gas efforts for the interstate market before the Commission can provide producers with a multi-million non-cost allowance which, unlike the contingent escalations of flowing gas rates and refund work-off provisions of the Commission's order approved in *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 318 (1974) are not tied to the sale of new gas to the interstate market, or even to producer expenditures of additional exploration and development funds in the pipelines' behalf.

The possibility that vintaging by contract date could impair new drilling on acreage already dedicated to interstate commerce may justify granting the new gas rate for new wells drilled on such acreage, as the Commission subsequently concluded in establishing its nationwide just and reasonable rates for new gas in Opinion 699-H, *supra*, or granting increases in flowing gas rates justified by discrete drilling programs as the Commission provided in Order No. 481, 49 F.P.C. 992 (1973),[6] in accordance with a proposal outstanding as of the date it issued Opinion 639. But it does not

[6] *Policy With Respect to Sales Where Reduced Pressures, Need For Reconditioning, Deeper Drilling or Other Factors Make Further Production Uneconomical at Existing Prices.* The policy was incorporated into the Commission's Rules as Section 2.76, 18 C.F.R. § 2.76. See also *Shell Oil Company*, 49 F.P.C. 108 (1973).

justify providing higher rates for flowing gas without any showing that they will benefit the pipeline or its consumers. And even if the Commission prior to the establishment of any area rates had contemplated that the differential between flowing and new gas rates would eventually disappear, which it did not,[7] the Commission could not subsequently take this action unless it had a far better factual basis for believing that the large additional cost would benefit gas consumers. At a very minimum, since the Commission did not, as it could not, make such findings in its policy statement in Opinion 639, it could not permit individual increases to become effective pursuant to its policy where, as here, there was no showing made that the increased revenues would be utilized by the producers to augment the gas supply for the pipeline.

CONCLUSION

The Public Service Commission of the State of New York does not seek to freeze the rates at which producers sell natural gas to the pipelines serving the interstate market. Even with respect to flowing gas we are aware that there will be situations in which additional gas can or will be made available if the producer, as consideration for his additional efforts is afforded appropriate rate relief. But the Commission's policy to authorize producers to secure new gas rates

[7] For the proposition that it had expected the differential to wither away Opinion 639 cites (48 F.P.C. at 1309), the Commission's Statement of General Policy No. 61-1, 24 F.P.C. 818, issued in 1960 prior to the initiation of any area rate proceedings, where the Commission said it expected that the differentials between its "guideline" prices for initial certification of new gas sales and for accepting increased rate filings without suspension would disappear over a period of time. However, the different initial and increased rate guidelines established for most of the production areas, were unrelated to the date of original production or contractual commitment of the gas to the interstate market, or to the subsequent development of and rationale for the two-price area rate policy. See *Permian Basin Area Rate Cases*, 390 U.S. 747, 759-60 (1968).

for their oldest and lowest cost flowing gas whenever they enter into replacement contracts with the pipeline, and without any showing that they will devote any of the increased revenues to the interstate market, is wholly unsupported by findings or record evidence as to the likelihood of producing substantial additional gas for the pipeline's customers. In fact, the policy is likely to be counter-productive since producers who might agree to further development efforts in return for increased rates are less likely to do so when they can secure the additional revenues without any additional effort.

The decision of the Court below is thus not only erroneous, but raises serious questions as to the proper administration of the Natural Gas Act warranting plenary review by this Court. Accordingly, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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